



LIVE: CASH FLOW & RATIOS

04 JULY 2014



Lesson Description

In this lesson we:

- Work through various questions and answers relating to Cash Flow & Ratios.



Exam Questions

Question 1 (70 marks; 40 minutes)

You are provided with information relating to Bellco Limited for the year ended 31 August 2013.

- 1.1 A company's published annual report comprises five main parts. Match the first column with the description in the second column. The first one has been done for you as an example (i.e. 1 = C).

COLUMN 1		COLUMN 2	
Components of the annual report		Description	
1	Income Statement	A	A written verbal explanation of operations of the company during a financial year
2	Balance Sheet	B	Reflects whether or not the shareholders can rely on the financial statements
3	Cash Flow Statement	C	Reflects the profit/loss of the company
4	Directors' Report	D	Reflects the effect of the operating, financial and investing activities on the cash resources
5	Independent Auditor's Report	E	Reflects the net worth of the company

(8)

- 1.2 Complete the Cash Flow Statement for the year. Show workings in brackets. (21)

- 1.3 Calculate the following financial indicators for 2013:

- 1.3.1 Acid-test ratio (4)
- 1.3.2 % Return on average shareholders' equity (4)
- 1.3.3 Debt / equity ratio (3)
- 1.3.4 % Return on average capital employed (use net income before tax) (4)





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- 1.4 The directors are pleased that the operating efficiency of the business has improved. Quote and explain two financial indicators to support their opinion. (4)
- 1.5 According to the Companies Act, the directors may repurchase shares only if the liquidity of the business is acceptable. Quote and explain three financial indicators which provide evidence that they have complied with the Act. (6)
- 1.6 The directors want to establish another branch in a different area next year. They will need finance of R1,5m to do this. One of the directors has suggested that they finance the expansion by increasing loans instead of issuing new shares.
- Quote and explain two financial indicators to support his opinion.
 - Explain two other factors, with advice, that the directors should consider before embarking on this expansion. (8)
- 1.7 Refer to the extract of the Independent Auditor's Report under Information 6.
- Explain in your own words why it is necessary for the independent auditors to mention internal controls under the section on Directors' Responsibility. (2)
 - Under the section on Independent Auditor's responsibility, they mention something about 'ethical requirements'. Provide a practical example of this. (2)
 - Is their final opinion a good one or not? Explain. (2)
 - Why is it necessary for the Independent Auditor to have the qualification CA (SA) behind him name? Explain. (2)

INFORMATION:

1. **Extracts from the Balance Sheet for the year ended 31 August:**

	2013	2012
Fixed assets	12 138 000	12 357 000
Investments (4% p.a.)	250 000	600 000
Current assets	3 465 000	3 200 000
Trading stock	1 720 000	2 250 000
SARS (Income tax)	65 000	0
Trade & other receivables (excluding SARS)	1 140 000	940 000
Cash & cash equivalents	540 000	10 000
TOTAL ASSETS	15 853 000	16 157 000
Shareholders' equity	11 011 400	8 595 000
Share capital	8 960 000	6 360 000
Retained income	2 051 400	2 235 000
Loan from Unity Bank (11% p.a)	3 000 000	5 400 000
Current liabilities	1 841 600	2 162 000
Trade & other payables (excluding SARS & shareholders)	920 000	1 260 000





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SARS (Income tax)	0	72 000
Shareholders for dividends	921 600	620 000
Bank overdraft	0	210 000
TOTAL EQUITY & LIABILITIES	15 853 000	16 157 000

2. **Extracts from the Income statement and Notes for the year ended 31 August 2013:**

Depreciation	R 1 010 000
Operating profit	3 062 000
Interest expense	462 000
Net profit before tax	2 600 000
Net profit after tax	1 820 000
Interim dividends paid	770 000
Final dividends declared	921 600

3. **Shares issued & repurchased:**

- 1 000 000 ordinary shares were in issue at the end of the previous financial year, 31 August 2012.
- 400 000 ordinary shares were issued on 1 September 2012.
- 120 000 ordinary shares were repurchased on 28 February 2013 from the estate of a shareholder who had died. The shares were repurchased at R2.60 above the average issue price.

4. **Changes to fixed assets:**

New vehicles and equipment were bought during the year for R880 000.
Unused vehicles were sold at book value during the year.

5. **Financial indicators for the past two years:**

	2013	2012
Solvency ratio	3,3 : 1	2,1 : 1
Current ratio	1,9 : 1	1,5 : 1
Acid-test ratio	?	0,4 : 1
Turnover rate of stock	8,7 times	6,6 times
% Return on average shareholders' equity	?	15,6 %
Net asset value per share	860,3 cents	859,5 cents
Earnings per share	135,8 cents	114,2 cents
Dividends per share	127 cents	30 cents
Debt/equity ratio	?	0,6 : 1
% Return on average capital employed	?	12,4 %
% Gross profit on cost of sales	62,2 %	58,3 %
% Operating expenses on sales	37,9 %	44,5 %
% Operating profit on sales	10,1 %	7,3 %





6. **Extract from the Independent Auditor’s report. Note that this is not a complete report.**

REPORT OF THE INDEPENDENT AUDITOR

We have audited the annual financial statements of Bellco Limited as set out on pages 52 to 64.

Directors’ Responsibility for the Financial Statements

The Company’s Directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and the requirements of the Companies Act of South Africa, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Independent Auditor’s Responsibility

Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

Opinion

In our opinion, the annual financial statements present fairly, in all material respects, the financial position of Bellco Limited as at 31 August 2013, and its financial performance and cash flows for the 52 weeks then ended in accordance with International Financial Reporting Standards, and the requirements of the Companies Act of South Africa.

MSANE & CHARTER
Director: MPJ Msane
Registered Auditor; Chartered Accountant (SA) 15 September 2013

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Answer Book

Question 1

1.1

1	2	3	4	5

5





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**1.2 BELLCO LIMITED
CASH FLOW STATEMENT FOR YEAR ENDED 31 AUGUST 2013**

Cash effects of operating activities	1 293 000
Cash generated from operations	4 062 000
Interest paid	(462 000)
Cash effects of investing activities	
Cash effects of financing activities	
Net change in cash & cash equivalents	
Cash & cash equivalents at beginning of year	
Cash & cash equivalents at end of year	540 000

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1.3.1 Calculation of Acid-test ratio

4

1.3.2 Calculation of % Return on average shareholders' equity

4





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1.3.3 Calculation of Debt / equity ratio

3

1.3.4 Calculation of % Return on average capital employed (use net income before tax)

4

1.4 The directors are pleased that the operating efficiency of the business has improved. Quote and explain two financial indicators to support their opinion.

4

1.5 According to the Companies Act, the directors may repurchase shares only if the liquidity of the business is acceptable. Have the directors complied with this requirement? Quote and explain three financial indicators which provide evidence that they have complied with the Act.

6





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1.6

One of the directors has suggested that they finance the expansion by increasing loans instead of issuing new shares. Quote and explain two financial indicators to support his opinion.

Two other factors with advice that the directors should consider before embarking on this expansion:

Factor	Advice

10

1.7

Explain in your own words why it is necessary for the independent auditors to mention internal controls under the section on Directors' Responsibility.

Under the section on Independent Auditor's responsibility, they mention something about 'ethical requirements'. Provide a practical example of this.

Is their final opinion a good one or not? Explain.





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Why is it necessary for the Independent Auditor to have the qualification CA (SA) behind his name? Explain.

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